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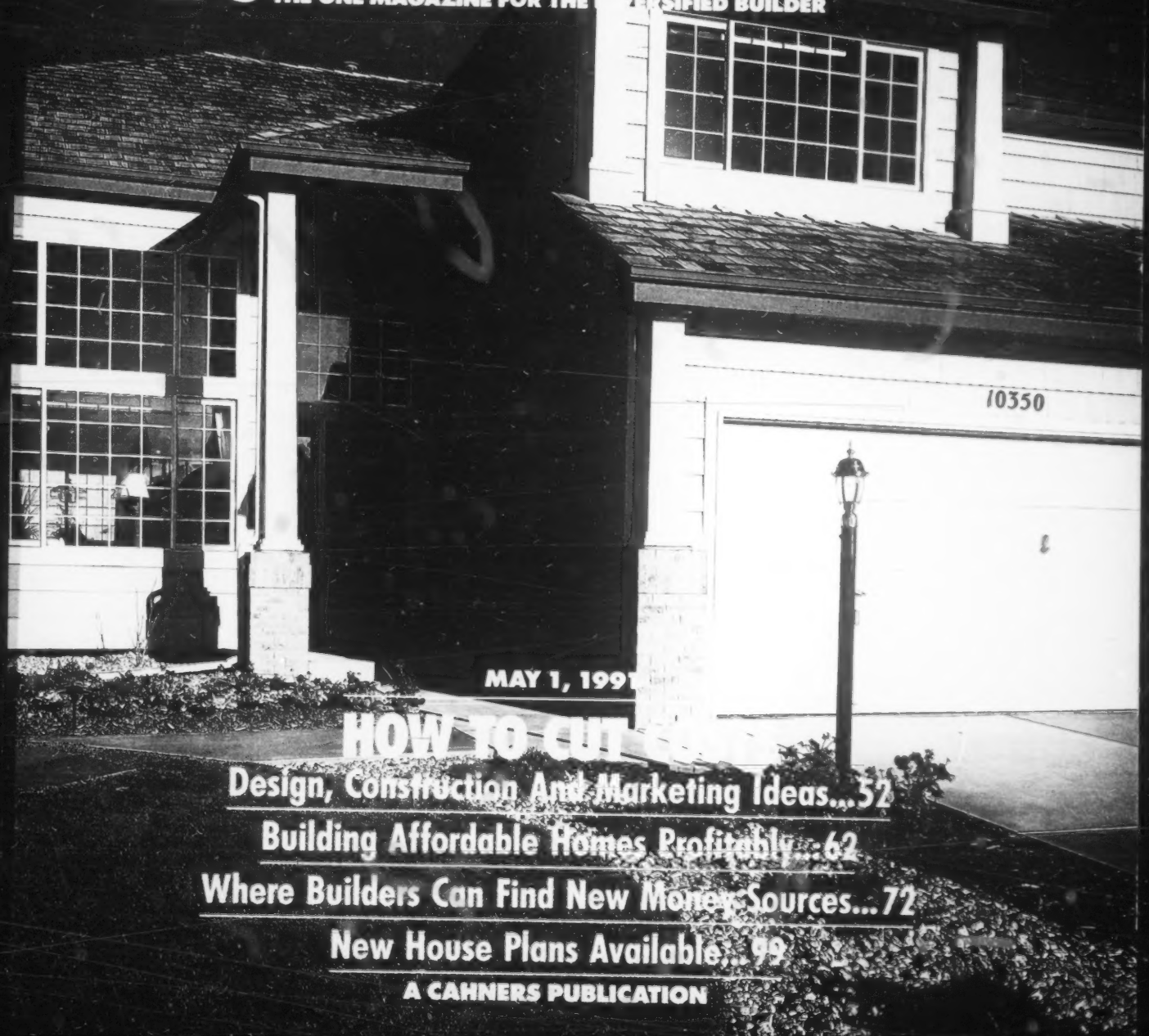

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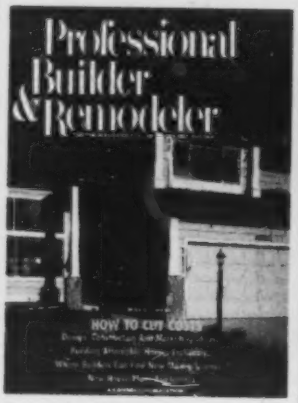

On The Cover

■ Falcon Homes' Sagamore neighborhood at Stonegate Village, Denver, features the La Paloma model, a 2246-square-foot home with a $132,950 price tag. Design was by Denver architects Knudson Gloss, with interiors by Hillary Reed. Photography by Sunlit Ltd.

QVA success—Quality, Value & Affordability: p. 62.

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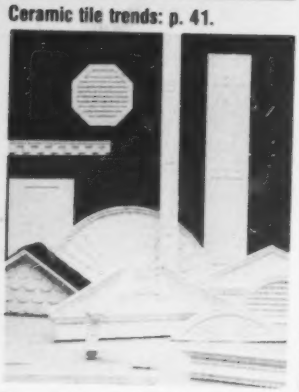
Let America Build Part X: New Money Sources 72

Builders tell how they've tapped private investors, joint venture partners, small lenders, government programs, insurance companies—even lumberyards—for financial backing.

Cost-cutting ideas from the field: p. 52.

Ceramic tile trends: p. 41.



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Business

■ In these still-nervous times, understanding buyer psychology and consumer confidence is critical to good business. The nation's Giant builders tell what they are doing to turn increased traffic into increased sales: *p. 12.* Legislative help to tackle the credit crunch and RTC woes may be on the way, but political infighting is sure to slow its course: *p. 20.*

Management

■ For many in the remodeling business, the art of pricing seems a blend of science and voodoo. But whether or not you think there can ever be a formula for pricing, certain important rules do apply. Leading remodelers share their estimating tips: *p. 31.*

Marketing

■ Creative tile installations can help sell homes. Just ask Carlyle Perry of C.V. Perry & Co., Columbus, Ohio. He employs an interior designer who studies tile trends. Take a look at some unusual applications, such as driveways: *p. 41.*

Technology

■ Innovative HVAC systems entering the market can offer utility-bill savings as well as a fresh-air environment in the home: *p. 79.* The new housing bill's energy initiatives are said to point the nation in a more efficient direction: *p. 80.*

Let America Build

Control Costs By Finding New Money

Sources

Let America Build: Part X

Handcuffed by the disruption of AD&C money due to FIRREA, the collapse of the domestic thrift industry, and uncertainty in financial markets, builders have been forced to seek out alternative sources. For most builders, this is becoming an issue of survival.

By David Heinly & Christina Farnsworth, Senior Editors

The approach of spring, an apparent surge in consumer confidence following a swift victory in the Persian Gulf War, and the holding of mortgage interest rates below the magic 10% level were among factors that helped account for February's surge in home building.

While those figures would not mean the recession was coming to an end, NAHB President Mark Tipton could say, "We probably turned the corner."

There was little, however, to indicate that an easing of the "credit crunch" was also in sight.

The plight of the thrift industry continued to deteriorate with an angry Congress forced to vote additional funds to finance the escalating cost of liquidating failed institutions. There also were few initial signs that federal bank examiners had eased their harsh scrutiny of lender portfolios in response to an earlier directive to ease, among other things, loss reserve requirements and accounting rules on certain "bad" loans.

But for many builders stymied by the abrupt cutoff of their traditional sources of Acquisition, Development and Construction financing, the only practical answer has been to seek out alternative sources, turning to new and often unfamiliar sources of potential credit. Survival has meant turning to unaccustomed methods and practices often at odds with what were once tried-and-true business strategies.

"Things have gotten very much better in just the last couple of weeks," says Charlottesville, Va., builder Suzanne Grove. A builder chiefly of custom-spec homes for a normally active transferee market related to the nearby University of Virginia, Grove felt the impact of the credit crunch as sharply as any. She stopped building last year when potential buyers found themselves unable to sell their existing homes in other areas.

But with the recent signs of a turnaround, Grove realized "I've got to get something started or I'm not going to have anything on the market."

Hoping to revive her upscale custom niche with units on lots she already owned, Grove turned to the S&L with whom she had worked for years and which, like many similar institutions, recently had converted to a savings bank.

Despite an approved line of credit secured by her own home and the fact that she had arranged permanent financing for *all* her buyers with the same institution, Grove was rejected. The bank found her plans for high-end custom homes too risky and advised her to build less expensive homes which, the bank indicated, they might finance.

Unwilling to abandon her niche for a market with which she had no experience, she turned to a **competing lender**. Grove, who is a national director of NAHB, is counting on her reputation for success, for sound business judgment and, significantly, for having never defaulted on a loan.

Her strategy is to pledge her buyers' permanent financing as part of

The three-dimensional mixed media and currency collages shown throughout this story are the work of Barton Lidice Benes represented in Chicago by the Hokin Kaufman Gallery. Above is "Palette" 1990. Photos: Marc Barlow

the deal for her own construction loan. "The best thing that any builder can do," she says, "is to be very upfront, very candid and very forthcoming with whoever their lending institution is.

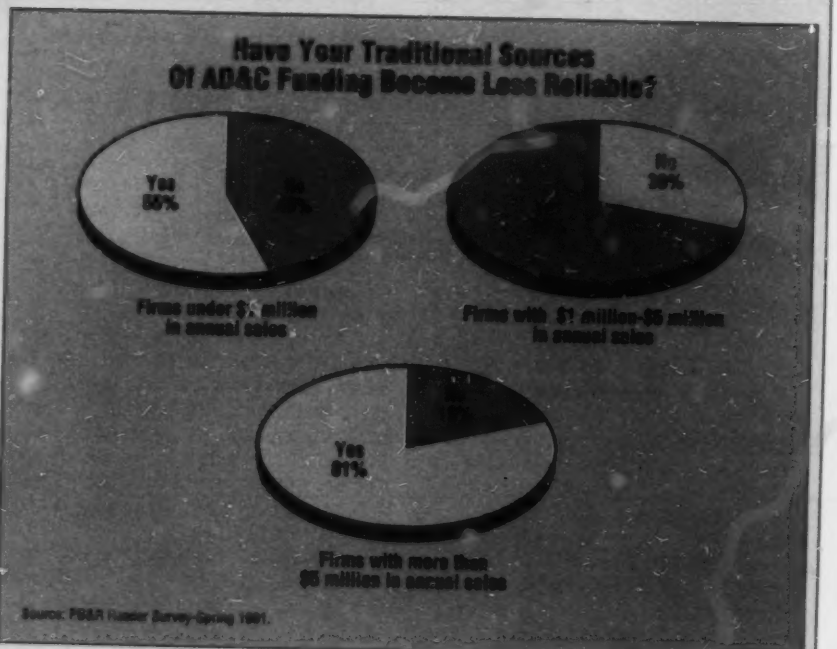
"If I'm going to be even a day late, I call them and tell them," she says. "It's really important to keep in close touch with them. Then they don't get as worried."

Ormond Beach, Fla., builder Andrew H. Gibbons found the credit crunch a double-barreled blast for construction loans. Florida S&Ls, says Gibbons, not only were impacted directly by the federal examiners' crackdown but indirectly by the collapse of S&Ls elsewhere in the country.

With a predominantly transferee market—95% of his customers are emigres from the Northeast—Gibbons found that his buyers, mindful of the thrift disasters "back home," would not seek mortgage loans from Florida thrift institutions.

"So then the commercial banks started doing it all," he says. "Now my spec loans come out of commercial banks also, even though at one time commercial banks didn't want to do loans on specs."

Gibbons, who formerly had credit lines outstanding with five different institutions, says he has found little difference in doing business


Have Your Traditional Sources Of AD&C Funding Become Less Reliable?
Yes 85%
Yes 39%
Yes 81%
Firms with more than $5 million in annual sales
Source: PB&R Hunter Survey-Spring 1991.

Let America Build

Credit is easing in some markets as experienced S&L loan officers join commercial banks

with commercial banks or with S&Ls. The key, he says, has been his excellent reputation, the longevity of his business (14 years) and the fact that "commercial banks seem to be a little more professional with the people (individual borrowers as compared with commercial borrowers)."

The banks, he says, have outgrown the tendency to "run hot and cold" (arbitrarily doing spec loans on one occasion yet withholding funds on another). Many would also refuse to do loans combining spec or construction loans with permanent buyer loans, offering instead to do "a construction loan at prime plus and then do a closing down the road on the home buyers."

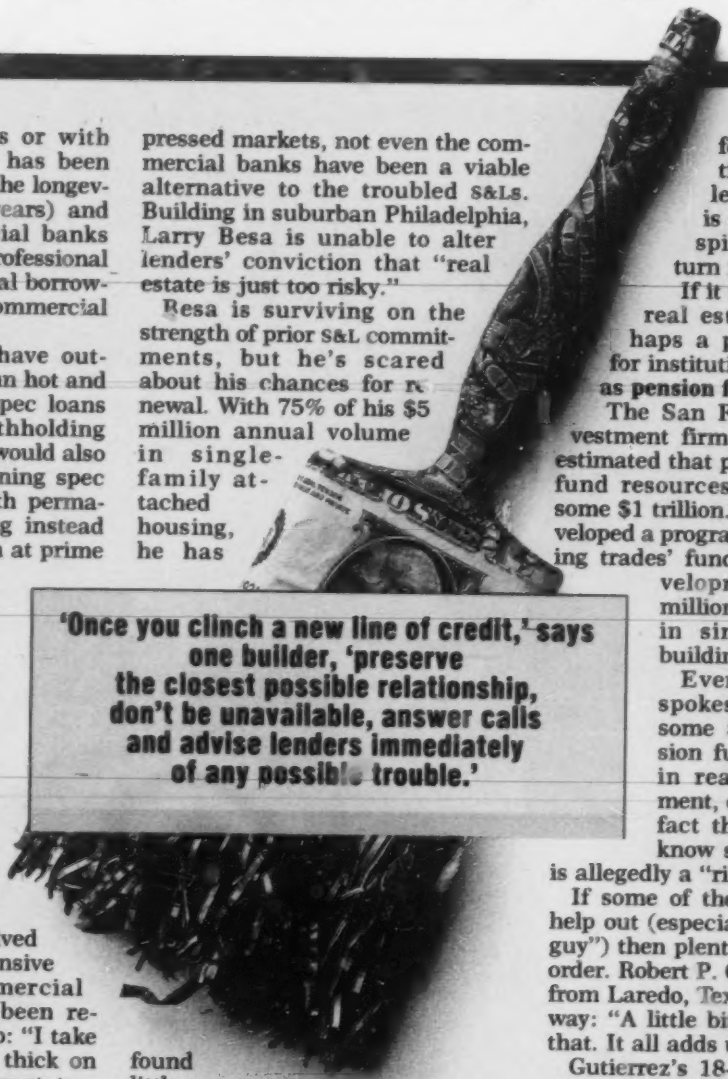
Things changed, Gibbons says, in part because some S&L loan officers had joined the commercial banks, so that in many instances the banks had come to him seeking his business. "The commercial banks are even able to do a little bit better on spec lending rate structure."

Gibbons also has perceived a need for more comprehensive presentations to commercial banks than might have been required just a few years ago: "I take them a package 4 inches thick on the company. They all want two years of history on company performance—I give them five."

Gibbons is a family-owned business begun some 15 years ago by his father (who had been a mortgage banker for 10 years before that). The son learned many lessons about banking, and now he says, "When I go to meetings, I don't talk to other builders—I talk to bankers, about their plans, rate trends and whether they will qualify certain buyers. It helps me, and it helps my buyers."

For many builders in severely depressed markets, not even the commercial banks have been a viable alternative to the troubled S&Ls. Building in suburban Philadelphia, Larry Besa is unable to alter lenders' conviction that "real estate is just too risky."

Besa is surviving on the strength of prior S&L commitments, but he's scared about his chances for renewal. With 75% of his $5 million annual volume in single-family attached housing, he has found little lender interest in what has been a depressed market.



'Once you clinch a new line of credit,' says one builder, 'preserve the closest possible relationship, don't be unavailable, answer calls and advise lenders immediately of any possible trouble.'

Turning to insurance companies has yielded no help, he says, because major lenders (including pension funds and even foreign investors) seem interested only in large operations with management depth, market expertise, and above all, volume: "The little guy hasn't got a prayer."

Lenders, he adds, are demanding higher equity with builders already owning the land and development infrastructure already in place before doing construction loans. For most lenders, "real estate is just too risky," despite signs of an upturn in demand.

If it is risky for bankers, real estate looms as perhaps a prohibitive gamble for institutional investors such as pension funds.

The San Francisco-based investment firm of McMorgan Co. estimated that private U.S. pension fund resources last year totaled some $1 trillion. McMorgan has developed a program to package building trades' funds into housing development. Some $300 million had been invested in single-family home building last year.

Even so, a company spokesman says, only some 5% of trades' pension funds were invested in real estate development, due basically to the fact that fund managers know so little about what is allegedly a "risky business."

If some of the "big boys" won't help out (especially with the "little guy") then plenty of creativity is in order. Robert P. Gutierrez, a builder from Laredo, Texas, sums it up this way: "A little bit of this, a little of that. It all adds up."

Gutierrez's 18-year-old company, Armadillo, has just finished climbing out of a deep hole. In 1982, he was $20 million in debt. The RTC took over the S&L that he had a $2.5 million line of credit with and a $1 million loan that was in default on a condo project. RTC officials told him that they could not continue doing business.

However, Gutierrez was able to talk the S&L officials into allowing him to sell the condos at a fire sale (it netted them 65 cents on the dollar) and then forgive the rest of the outstanding loan. His action got rid of a soured project, a bad debt and

at least partially saved Armadillo's credit rating.

He then turned to a **private investor**. Gutierrez asked that investor to pledge a $250,000 certificate of deposit as collateral on a $1 million line of credit with a local bank. The risk for the investor was losing the CD. The potential benefit was getting the 8% interest the bank was already paying on the CD plus another 6% from Armadillo—a total of 14% interest on the CD money.

From there, Gutierrez talked a **land owner** into subordinating land to build houses on. He signed a note with the land owner, who agreed to accept payment when Armadillo had closed on the house loan. The land owner then gave clear title to the bank before construction began and took a second lien position.

After three or four years of doing business with the land owner by this method, Gutierrez pointed out that he could sell houses and lots faster if he could build spec homes. The banks would not fund spec homes. So he talked the land owner into providing Armadillo with a $250,000 line of credit at 17% interest to built spec houses on the subordinated lots.

How did Gutierrez talk private investors into taking such risks? He cites his 18-year track record and notes that Texas was blindsided by the depression—one day houses and condos were selling, the next day they weren't.

Gutierrez also works with **joint venture** partners. The partner signs the note for the loan. Armadillo builds, markets and sells the houses. Armadillo and the partner split the profits 50/50. Successful friends are the source of much joint venture financing, though he cautions that you take care with such relationships not to jeopardize the friendship.

Sometimes getting money requires recasting the product to fit **smaller lenders'** pocket books. Bob Wolfe, project manager with the Pasadena, Calif.-based Whitehawk Partnership, is working to rephase a project. Unable to get financing to complete the last 138 units of a 288-unit project, the company has returned to local officials to recast the project in phases of 40 units each. Smaller-size phases require smaller loans and make the project accessible to smaller lenders.

For small-volume builders, especially those with volume less than $2 million annually, home buyers can often provide the construction financing. Many custom builders in particular use **owner financing** for construction. Buyers may find it easier to get credit than builders; the loan truly qualifies and commits the home buyer. The benefit to the buyer is the immediate use of the home mortgage interest deduction.

In Blaine, Minn., near the twin cities, Betty Hardle of Good Value Homes has gone to local **lumber yards** for financing. Several Minnesota lumber companies have developed financing subsidiaries, a logical extension of activity, since builders without financing cannot build and have no need to buy lumber.

With annual volume averaging $28 million, Good Value Homes had terrific financing with an open line of credit with a pair of local banks. It was easy to finance houses without a lot of documentation. But that relationship was disrupted when the bank adopted a different lending policy.

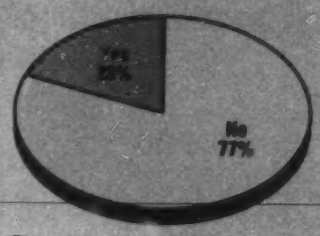
Under the new arrangement, the lumber company's financing arm charges more interest than the bank did and requires extensive loan documentation. Hardle estimates that the extra interest costs and overhead add from $500 to as much as $1000 to the cost of a house. On the other hand, she says it is a pleasure to deal with people who know and understand the building business.

J.J. Molinar of Gemcraft in Phoenix has found it so difficult to get financing for new construction that he has turned to **low-income housing rehabilitation**. In one case, he rehabilitated 31 houses that the city owned outright as part of a project to give housing to single-parent households headed by women. He is also doing work with the RTC and the Farmers Home Administration.

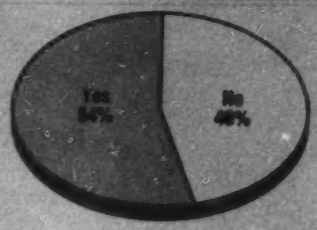
There is no money for new construction through **government programs**, he says, but there is rehab work available through non-profit groups that have gotten rehab funding through the government.

There are new money players in the field, and they are looking for

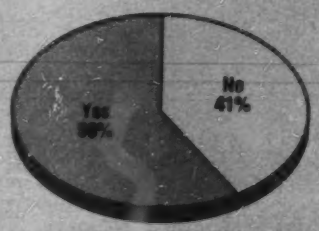
Have You Cultivated New Sources Of AD&C Financing?



Firms under $1 million in annual sales



Firms with $1 million-$5 million in annual sales

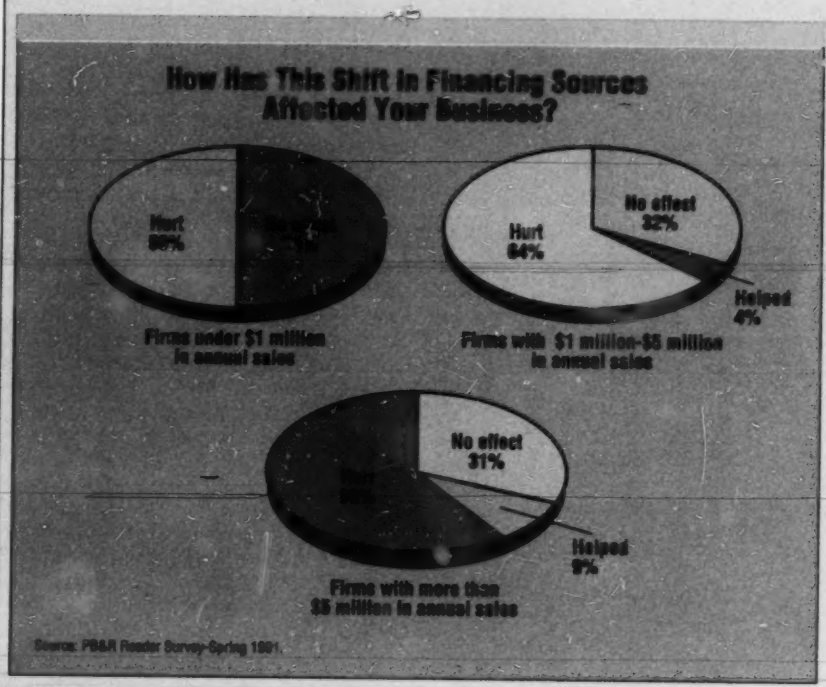


Firms with more than $5 million in annual sales

Source: PB&R Reader Survey-Spring 1991.

Let America Build

There's great hope for the secondary market for construction loans approved by Fannie Mae and HUD


How Has This Shift in Financing Sources Affected Your Business?
Hurt 80%
Firms under $1 million in annual sales
Hurt 64%
No effect 32%
Helped 4%
Firms with $1 million-$5 million in annual sales
No effect 31%
Helped 9%
Firms with more than $5 million in annual sales
Source: PB&R Reader Survey-Spring 1991

business. Charlie Knutson, Knutson Brothers Builders, West Allis, Wisc., is a professional residential remodeler. Though he can still get his clients financing through S&Ls, other lenders such as **consumer finance companies**, are shopping him for his business.

However, Knutson finds that one of his biggest challenges is educating lenders. Clients will call their lender for a home equity loan. The lender will ask what the "appraised tax value" of their house is. In many parts of the country, the appraised tax value is a great deal lower than market value.

Knutson can help buyers get financing through lenders who will appraise the house at "market value" and base their loan on that. Knutson also is encouraging lenders to lend (as they do on new construction) based on the value of a home once it is remodeled. Even on modestly valued homes, these distinctions can result in a significant amount of available money.

Stephen Wickens, Wickens Development Corp., Lansing, Mich., however, sees a big positive to the credit crunch. A second-generation builder, he feels that a lot of marginal projects and marginal players have been weeded out of the business. Wickens does 80% multifamily construction built and held for its own investment and 20% commercial construction.

Even though Wickens can provide substantial equity for his projects and has a good relationship with local banks, he is still looking at other sources for financing. They have done one **Delegated Underwriting and Servicing loan (DUS)**. These loans are available through lenders that Fannie Mae has screened and approved. They serve almost as surrogate Fannie Mae lenders approving and underwriting loans. There is risk sharing for potential losses on such loans. The project included 68 existing units that were 15 years old to which they added 120 new units.

He also has obtained a three-year miniperm loan for a current project with the hopes of getting **insurance company** financing down the road when the project is entirely finished and fully leased. Insurance companies, he points out, cherry pick, so only the best projects get financing.

One of the respondents to *PB&R*'s survey with an annual dollar volume of $6.7 million, wrote that their company was looking at **foreign investors** but having no luck—"Too many scams, no substance."

But some larger companies would disagree. RGC in Newport Beach, Calif., has had great success in joint venturing with foreign investors. E. James Murar, chairman of the company, feels that the window of opportunity for builders to form relationships with foreign investors may be closed for at least a year. Murar began developing his ties with foreign investors early in 1989.

To find such investors, builders usually need to go through intermediaries. There are companies set up specifically to serve as intermediar-

ies, although some large banks and accounting firms also serve as go-betweens.

Foreign investors are as sensitive to the intuitive feeling they have about a partner and the location of the property as they are about numbers needed to make the deal work.

Murar feels that RGC and his Japanese investor partners moved quickly through a series of meetings that began in April 1989 that resulted in structuring their first venture in September 1989. Many ventures take much longer. RGC structures its foreign ventures as partnerships in which RGC is the general and the foreign investor the limited partner. The Japanese brought construction capital from a Japanese bank as part of their deal. Another venture involving a Saudi Arabian businessman included an Islamic bank as a lender for the project.

It is crucial, Murar feels, to treat foreign partners as you would like to be treated—on equal footing with respect for them personally and an understanding of their customs. Murar also says that it is important for the senior-level people to dedicate their time to building the relationship and structuring the deal.

Another hopeful sign is a **secondary market for construction loans** approved earlier this year by Fannie Mae and HUD.

Under what is to be a pilot program limited to $100 million in total commitments, Fannie Mae will purchase up to $50 million in lender originated construction loans for single-family housing.

Lenders must pass muster by 1) having a long, successful history in single-family construction lending; 2) be unable to make the loan to an existing borrower because the loan would push the lender over the legislated limit on loans to one borrower (under the Financial Institutions Reform and Reconstruction Act of 1989), and 3) be a regulated institution under supervisory organizations such as the FDIC.

Builder borrowers must also meet criteria as successful, long-time builders in single-family housing in the same geographical market and with the participating lender. The builder must be "in strong financial condition" with documenting statements and credit references. Maximum individual loans may be no more than $6 million with a term of no more than 18 months, although extensions are granted.

Fannie Mae officials say the response to the initial January announcement has been substantial, with more than 500 inquiries by early March. The first applications were expected by early Spring.

(Builders and lenders can request further details from the Federal National Mortgage Association, 3900 Wisconsin Ave., N.W., Washington, D.C. 20016-2899. Telephone: 202-752-7000.)

Overall, most builders interviewed were upbeat. This is a time, many said, of getting back to the basics. Gutierrez, for example, no longer buys trucks for his project managers; he gives them an allowance. Through precise estimating, he has gotten his project variances down to about 1%. He also has his own lumber company.

Wickens says the best advice is not to overextend yourself. His company does one project at a time. You must have enough liquidity to get through the project. "The hard cash dollar investment is what makes a difference to the lenders today," Wickens says.

Nevertheless, as Florida builder Gibbons says, "The bottom line for the sales and the banking institutions is that, for us as builders, it's going to be a rocky road for a long time." □

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INDICATORS

The Worst Is Behind Us For New Construction

But the economic upturn, while inevitable, will be slow to unfold.

Housing starts surged ahead in February, reflecting post-War builder optimism that the recession will soon be behind us. At an annualized rate of 989,000 units, total starts were still abysmally low. However, the number was slightly ahead of December's home construction pace and 16% higher than the depressed January level.

Both single-family and multifamily starts moved ahead impressively in February. Although regional numbers must be interpreted with caution, they give a sense of what regions could lead the recovery. February starts in the Northeast were flat—further evidence that the bottom has finally been reached here—while the West continued to slide. The South showed a modest rebound and the Midwest recorded a sharp increase.

Consumer confidence should improve as we move through the year—partly post-War optimism, but primarily because the economy will move out of the recession. Affordable interest rates will help, and an easing in credit constraints should make more money available to builders. However, all of these positive developments—while inevitable—will be slow to unfold. The total of 1.16 million units will be heavily concentrated in the second half of the year, with the strong momentum carrying over into 1992. □

Size Of New Homes Increased Again During 1990

According to preliminary data from the Commerce Department, the average size of new single-family homes completed during 1990 was 2080 square feet. The median size was 1905 square feet. Both numbers again established new records. New homes with 2400 or more square feet of floor area represented 29% of the 965,000 new single-family homes completed last year, up from just 21% three years earlier.

The average and median sizes of units in newly constructed multifamily buildings also increased last year, to 1010 and 955 square feet, respectively. Forty-four percent of all multifamily units completed last year had two or more bathrooms, up from 39% just three years before, while 11% of the newly completed units had three or more bedrooms, up from only 7% during 1987. □

PB&R Leading Indicator

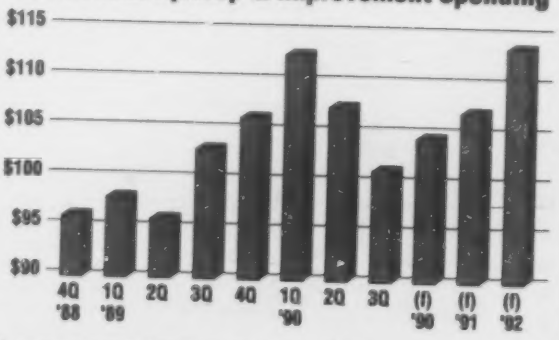
Broken line denotes forecast. Leading indicator of housing predicts short-term changes in residential construction over approximately the next quarter. Latest figure is based on May data and includes the Standard and Poor's h-h stock index, 90 day T-bills, bank reserves, consumer confidence index and the ratio of homes for sale to those sold. Prepared exclusively for PB&R by Cahners Economics.

Regional Market Conditions
(Year-To-Date Trends)

	S-F Home Permit $	Average S-F Permit Value	Remodeling Permit $	Employment Change
Portland, Maine	-22.5%	$95,382	-7.2%	-1.3%
Harrisburg	-9.1%	$81,403	-1.9%	+2.8%
Orlando	-3.8%	$88,625	-13.4%	+2.8%
Knoxville	+5.8%	$80,456	+5.4%	-1.7%
San Antonio	+4.8%	$82,414	-18.8%	+1.8%
Milwaukee	+1.8%	$109,374	+3.2%	+1.7%
Omaha	+6.3%	$70,309	-2.3%	+2.4%
Salt Lake City	+18.2%	$87,839	-43.1%	+2.9%
San Diego	-34.5%	$174,476	+15.4%	+2.1%

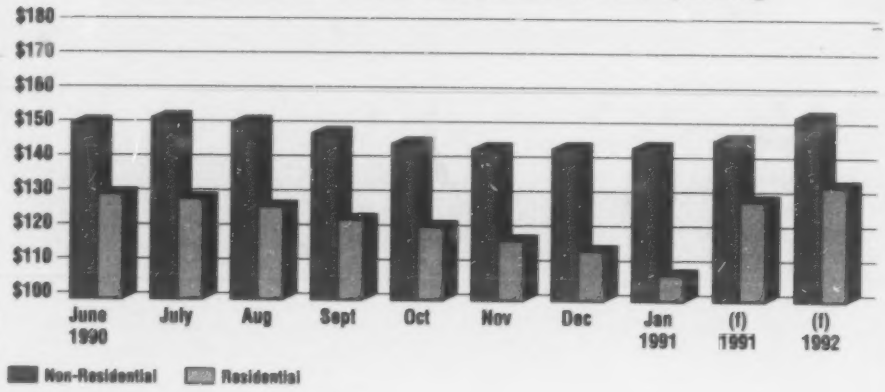
Source: U.S. Departments of Commerce and Labor.

Residential Upkeep & Improvement Spending



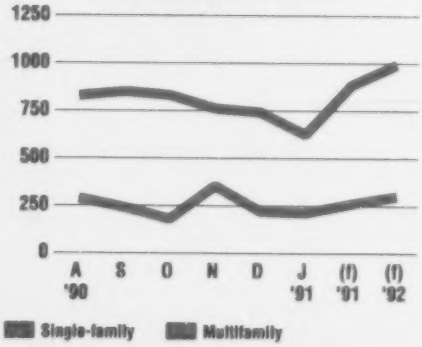
Data reflect seasonally adjusted annualized rates, in $billions.
Source: U.S. Department of Commerce. Forecast: Cahners Economics.

Non-Residential & Residential Construction Spending



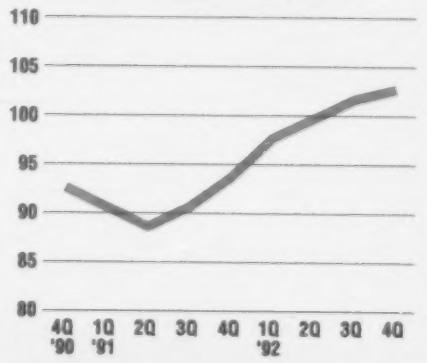
Data reflect seasonally adjusted annualized rates in $ billions.
Source: U.S. Department of Commerce. Forecast: Cahners Economics.

Housing Starts



Data reflect seasonally adjusted annual rate in thousands.
Source: U.S. Department of Commerce. Forecast: Cahners Economics

PB&R Market Forecast

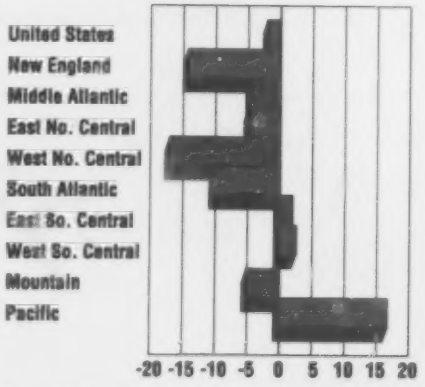


Index represents weighted average of forecast trends in residential, remodeling and light-commercial construction markets. Data are expressed in "real" terms, i.e. adjusted for the effects of inflation.

Source: Cahners Economics

Residential Remodeling Permit Value Trends

(Year-To-Date 1991 vs. 1990)



Source: U.S. Department of Commerce.

Key Trends At A Glance

	Jan 1991	Dec 1990
Total housing starts*	850	975
New home sales*	408	485
Remodeling permit trend	-2.0%	+1.9%
Consumer confidence index**	55.1	61.2
Median new home price***	$121.8	$126.9
Fixed-rate mortgages	9.64%	9.57%
Construction wage trend	+1.8%	+1.5%

* Seasonally adjusted annual rate in thousands.
** 1985 = 100.
*** In thousands.

1990 Inventory Of New Houses For Sale Declined Sharply

When home buyers start to return to Realtors' offices and model homes in earnest—and there is at least anecdotal evidence that suggests that this long-awaited phenomenon has already begun—the home building industry is in a good position to benefit immediately. Not surprisingly, given the sustained period of declining new construction activity, the supply of unsold new homes on the market is at an unusually low level.

According to Commerce Department data, the inventory of new single-family homes for sale at the end of 1990 totaled 322,000 units. This was down from the 366,000 units unsold at the end of 1989 and represented the smallest number of new homes on the market since the end of 1983. Of the 322,000 homes, 118,000 (36.6% of the total) were completed and ready for sale, 147,000 were under construction (45.7%), and the remaining 57,000 (17.7%) were units for which building permits had been issued but had not yet been started.

Between 1984 and 1989, an average of 363,000 single-family homes were available for sale at the end of the year. With the current inventory level more than 11% below this average, there is good reason to expect that additional supply will have to follow closely on the heels of a significant pick-up in consumer demand—a pick-up that should soon be in evidence. □